1960
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BETWEEN:

THE MINISTER OF NATIONAL REVENUE ..... APPELLANT;

AND

PILLSBURY HOLDINGS LIMITED ....RESPONDENT.

Revenue—Income—Income tax—Appeal from income tax assessment—Payments or benefits flowing from corporation to shareholder—Waiver of interest on loan to shareholder—Whether corporation and shareholder dealing at arm's length—Transaction not within s. 8(1)(c) if bona fide—Transactions which are devices or arrangements for conferring benefit or advantage on shareholder qua shareholder—Onus of proof with respect to assumptions alleged to have been made in assessing taxpayer—Allegations made by Minister in notice of appeal—Onus of proof in appeals from income tax assessment—Income Tax Act, R.S.C. 1952, c. 148, s. 8(1).

The respondent was the majority shareholder in each of two subsidiary companies, Renown Mills Limited and Copeland Flour Mills Limited. In 1952 it borrowed $500,000 from Renown and $560,000 from Copeland which it used to purchase shares in these two companies, giving in respect of each loan a demand promissory note bearing interest at 4½% payable semi-annually. In June 1953, in response to a request from the respondent, Renown and Copeland waived payment of interest for the first six-month period which ended on May 31, 1953. In May 1954

Renown and Copeland each accepted payment of its loan to the respondent and waived payment of interest thereon from May 31, 1953 to the date of payment.

The sole question in issue is whether the amounts payable by the respondent to the two subsidiary companies as interest on the loans, payment of which was waived by them, are required to be included in computing the respondent's income under s. 8(1) of the *Income Tax Act*.

Held: That s. 8(1) of the *Income Tax Act* is aimed at payments, distributions, benefits and advantages flowing from a corporation to a shareholder other than dividends during the lifetime of the corporation; payments and distributions in respect of reductions in capital during the lifetime of the corporation and payments and distrbutions on the occasion of the winding-up of the corporation.

2. That Parliament intended, by s. 8 of the *Income Tax Act*, to sweep into income, payments, distributions, benefits and advantages that flow from a corporation to a shareholder by some route other than the dividend route and that might be expected to reach the shareholder by the more orthodox dividend route if the corporation and the shareholder were dealing at arm's length.

3. That there can be no conferring of a benefit or advantage within the meaning of s. 8(1)(*c*) where a corporation enters into a *bona fide* transaction with a shareholder.

4. That s. 8(1)(*c*) clearly applies to transactions between closely held corporations and their shareholders that are devices or arrangements for conferring benefits or advantages on shareholders *qua* shareholders and it is a question of fact whether a transaction that purports, on its face, to be an ordinary business transaction is such a device or arrangement.

5. That even where a corporation has resolved formally to give a special privilege or status to shareholders, it is a question of fact whether the corporation's purpose was to confer a benefit or advantage on the shareholders or was some purpose having to do with the corporation's business such as inducing the shareholders to patronize the corporation.

6. That when the Minister sets forth in his Notice of Appeal the assumptions on which the assessment appealed from is based the taxpayer can meet this pleading by (*a*) challenging the Minister's allegation that he did assume those facts, (*b*) assuming the onus of showing that one or more of the assumptions was wrong or (*c*) contending that, even if the assumptions were justified, they do not of themselves support the assessment.

7. That, as an alternative to relying on the assumptions on which the assessment was based, the Minister may allege by his Notice of Appeal further and other facts that would support or help in supporting the assessment but the onus would presumably be on the Minister to establish such facts.

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8. That the waiver of interest payable by a borrower who is a shareholder of the lender is not a transaction to which s. 8(1)(*c*) applies unless it is also an arrangement or device whereby the corporation confers a benefit or advantage on the shareholder *qua* shareholder, and the Minister not having alleged that in making his assessment he assumed that to be so in this case, there is no onus on the respondent to disprove that fact which is essential to its being taxable.

9. That since the Minister has made no allegation that either the first or second round of waivers of interest constituted a device or arrangement for conferring a benefit or advantage on the borrower *qua* shareholder, the assessment cannot stand.

10. That the appeal is dismissed.

APPEAL from a decision of the Tax Appeal Board.

The appeal was heard by the Honourable Mr. Justice Cattanach at Toronto.

F. J. Cross, G. W. Ainslie and *D. H. Aylen* for appellant.

S. E. Edwards, Q.C. for respondent.

The facts and questions of law raised are stated in the reasons for judgment.

CATTANACH J. now (September 2, 1964) delivered the following judgment:

This is an appeal from a decision of the Tax Appeal Board[1] dated June 20, 1958, allowing an appeal by the respondent (whose name at that time was Pillsbury Canada Limited) from its assessments under the *Income Tax Act,* 1952, R.S.C., c. 148, for its 1953 and 1954 taxation years.

The appeals relate to certain amounts that were payable by the respondent in those years as interest on monies borrowed from two subsidiary companies, in each of which the respondent was a majority shareholder. The sole question in issue is whether subsection (1) of section 8 of the *Income Tax Act* requires that those amounts be included in computing the respondent's incomes for those taxation years by reason of certain resolutions passed by the lender

[1] (1958) 19 Tax A.B.C. 431.

companies which purport to relieve the respondent of its liabilities to pay those various amounts.

Subsection (1) of Section 8 of the *Income Tax Act* reads as follows:

> 8. (1) Where, in a taxation year,
>
> (*a*) a payment has been made by a corporation to a shareholder otherwise than pursuant to a *bona fide* business transaction,
>
> (*b*) funds or property of a corporation have been appropriated in any manner whatsoever to, or for the benefit of, a shareholder, or
>
> (*c*) a benefit or advantage has been conferred on a shareholder by a corporation,
>
> otherwise than
>
> (i) on the reduction of capital, the redemption of shares or the winding-up, discontinuance or reorganization of its business,
>
> (ii) by payment of a stock dividend, or
>
> (iii) by conferring on all holders of common shares in the capital of the corporation a right to buy additional common shares therein,
>
> the amount or value thereof shall be included in computing the income of the shareholder for the year.

The first question that arises is whether, assuming that the resolutions referred to had the effect of extinguishing the respondent's liabilities to pay the interest in question, the result was that benefits or advantages were conferred on a shareholder by the subsidiaries within the meaning of paragraph (*c*) of subsection (1) of section 8. As I reach the conclusion that that question must be answered in the negative, the appeal must be dismissed. If that question were answered in the affirmative, a number of other questions would arise which, by reason of the view that I take of the first question, I need not consider.

The facts relevant to the first question may be stated briefly.

On October 14, 1952, the respondent borrowed $500,000 from Renown Mills Limited (hereinafter referred to as "Renown") and $560,000 from Copeland Flour Mills Limited (hereinafter referred to as "Copeland") which money was employed with other money belonging to the respond-

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ent to pay for shares in those two companies. In respect of each loan, the respondent gave to the lender a promissory note payable on demand bearing interest at the rate of 4½% payable semi-annually.

At the time that the loans were made, the respondent acquired over 99% of Copeland's issued shares and all of Renown's issued shares except those that already belonged to Copeland.

In 1953, certain events took place in relation to the interest that fell due on May 31 of that year. On May 22, 1953, the President of the respondent, who was also President of Copeland and of Renown, wrote to Copeland as follows:

> On May 31st, 1953, the first payment of interest, amounting to $15,810 41 on the principal of our loan of $560,000 now outstanding, is due and payable to your company.
>
> For several reasons, principally due to organizational problems and operating conditions, this company finds itself without sufficient income and funds to meet this interest commitment on May 31st, 1953.
>
> Accordingly, we would respectfully ask that you consider formally and unconditionally waiving this interest charge for the period ending May 31st, 1953.
>
> We have every reason to feel confident our company will be operating as originally planned, to enable it to service its commitment and we hope substantially retire its indebtedness to you during the ensuing year.
>
> We anticipate your favourable consideration of our request.

On June 30, 1953, Copeland's Board of Directors adopted a resolution reading as follows:

> The Chairman read to the meeting a letter from Mr. R. J. Pinchin, President, Pillsbury Canada Limited, dated 22nd day of May, 1953, in which he referred to the loan which had been made by Copeland of $560,000 made to the Pillsbury Co. on October 15th last repayment of which was secured by a promissory note with interest. He indicated that as of May 31st of this year the amount of interest owing was $15,810.41.
>
> The letter from the President of Pillsbury pointed out that due to operating conditions and organization problems the company was without sufficient funds or income to meet this commitment and he requested that this Board give consideration to waiving the interest for this period.
>
> The matter was discussed, whereupon it was moved, seconded and unanimously carried,

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RESOLVED:

that in view of the communication referred to above and the financial situation of Pillsbury Canada Limited for the reasons appearing therein, this company unconditionally waive and forever forego the right to claim and receive from Pillsbury Canada Limited the sum of $15,810.41, being the interest on the loan made to the Pillsbury Company and due on the 31st of May 1953; provided that such waiver and renunciation shall not be or be deemed to be a waiver or renunciation of any future commitment of the Pillsbury Company to this company.

A similar letter was written by the President of the respondent to Renown and a similar resolution was adopted by Renown's Board of Directors.

In 1954, certain events took place affecting the interest that came due after May 31, 1953. On May 10, 1954, the respondent's Board of Directors adopted a resolution reading as follows:

The Chairman stated that it was desirable to repay to Copeland Flour Mills Limited the sum of $560,000 and to repay to Renown Mills Limited the sum of $500,000 which had been borrowed from these companies respectively on the 14th day of October 1952. He further stated that the creditor companies had each agreed to waive the payment of interest on these respective sums as and from the 31st day of May 1953 to date of payment providing such payments of principal were effected on or before the 31st day of May 1954.

The matter was discussed, whereupon it was moved, seconded and unanimously carried,

RESOLVED:

that the President be and he is hereby authorized to effect repayment of monies borrowed by the company as follows: to Copeland Flour Mills Limited the sum of $560,000 to Renown Mills Limited the sum of $500,000 provided always that such payments were in full settlement of all monies owing on these respective loans.

On May 10, 1954, Renown's Board of Directors adopted a resolution reading as follows:

The Secretary informed the meeting that he had been advised that Pillsbury Canada Limited was prepared to consider repayment of the sum of $500,000 and interest owing to the company by the Pillsbury corporation on condition that the company waive the payment of interest owing on this loan as and from the 31st day of May 1953. The matter was discussed, whereupon it was moved, seconded and unanimously carried,

RESOLVED:

that this company accept from Pillsbury Canada Limited the sum of $500,000 as in full payment for the loan for the said principal sum of

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$500,000 owing by Pillsbury Canada Limited as and from the 14th day of October 1952 and that the company specifically waive the right to receive any interest on such sum from Pillsbury Canada Limited as and from the 31st day of May 1953 to date of payment.

On May 11, 1954 Copeland's Board of Directors adopted an almost identical resolution.

The evidence is that, apart from the above, there were no written communications between the companies concerning these matters.

It is not possible, by an analysis of the language and function of subsection (1) of section 8, to find a simple formula for determining in advance the answer to all the questions that will arise under that subsection. Each question will have to be solved as it arises. Nevertheless, some consideration must be given to the function of this provision in the *Income Tax Act* and to the wording of the provision as a whole in considering the ambit of paragraph (*c*) in relation to the facts of this case.

The normal payments and distributions by a corporation to a shareholder *qua* shareholder are

(*a*) dividends during the lifetime of the corporation,

(*b*) payments and distributions in respect of reductions in capital during the lifetime of the corporation, and

(*c*) payments and distributions on the occasion of the winding-up of the corporation.

Provisions in the *Income Tax Act*, other than section 8, govern the taxability of such payments and distributions when made in the orthodox way. In the remainder of this judgment, when referring to dividends, I intend to refer to any of these payments or distributions referred to in this paragraph.

Subsection (1) of section 8 is aimed at payments, distributions, benefits and advantages flowing from a corporation to a shareholder other than those referred to in the immediately preceding paragraph. While the subsection does not say so explicitly, it is fair to infer that Parliament intended, by section 8, to sweep in payments, distributions, benefits and advantages that flow from a corporation to a

shareholder by some route other than the dividend route and that might be expected to reach the shareholder by the more orthodox dividend route if the corporation and the shareholder were dealing at arm's length. This is true of paragraph (*a*) of subsection (1). A corporation normally makes payments to its shareholders as dividends unless the payment is pursuant to a *bona fide* business transaction, in which event it is not a payment accruing to the shareholder *qua* shareholder. If a payment is made to a shareholder *qua* shareholder, paragraph (*a*) requires that it be brought into the shareholder's income whether or not it is made as a dividend. Similarly, as far as paragraph (*b*) of subsection (1) is concerned, the normal method whereby a corporation appropriates funds or property to, or for the benefit of, its shareholders is by a declaration of dividend payable in cash or in kind. If funds or property are appropriated to or for the benefit of a shareholder *qua* shareholder in any other way, paragraph (*b*) requires that they be brought into his income.

Paragraph (*c*) of subsection (1) of section 8 may be expected, therefore, to apply to cases where benefits or advantages have been conferred on a shareholder in such circumstances that the effect is, in substance, equivalent to the payment of a dividend to the shareholder. Where a corporation, for example, is in a business of providing services for a fee or other charge, and performs its services for one or more of its shareholders free of charge, the effect is, assuming that such shareholders would have used such services in any event, that the revenues of the corporation are less than they would be if such shareholders paid on the same basis as other customers and consequently there are less profits available for distribution to the shareholders by normal methods. Such a provision of services by a corporation to its shareholders, is one way whereby a corporation might confer a benefit or advantage on shareholders within the intent of paragraph (*c*). Similarly, a corporation that rents or lets property, real or personal, in the course of its business, might rent or let its property to a shareholder for nominal amounts. While I have referred to a corporation

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that does not charge a shareholder anything, or only charges a shareholder a nominal amount for something it does in the course of its business for customers other than shareholders, any corporation might resort to similar methods for conferring a benefit or advantage on shareholders even if it were not in the business of providing services or letting or hiring property.

By way of contrast, in my view, there can be no conferring of a benefit or advantage within the meaning of paragraph (*c*) where a corporation enters into a *bona fide* transaction with a shareholder. For example, Parliament could never have intended to tax the benefit or advantage that accrues to a customer of a corporation, merely because the particular customer happens to be a shareholder of the corporation, if that benefit or advantage is the benefit or advantage accruing to the shareholder in his capacity as a customer of the corporation. It could not be intended that the Court go behind a *bona fide* business transaction between a corporation and a customer who happens to be a shareholder and try to evaluate the benefit or advantage accruing from the transaction to the customer.

On the other hand, there are transactions between closely held corporations and their shareholders that are devices or arrangements for conferring benefits or advantages on shareholders *qua* shareholders and paragraph (*c*) clearly applies to such transactions. (Compare *Robson v. M.N.R.*[1]). It is a question of fact whether a transaction that purports, on its face, to be an ordinary business transaction is such a device or arrangement.

In applying paragraph (*c*) full weight must be given to all the words of the paragraph. There must be a "benefit or advantage" and that benefit or advantage must be "conferred" by a corporation on a "shareholder". The word "confer" means "grant" or "bestow". Even where a corporation has resolved formally to give a special privilege or status to shareholders, it is a question of fact whether the corporation's purpose was to confer a benefit or advantage

[1] [1952] 2 S.C.R. 223.

on the shareholders or some purpose having to do with the corporation's business such as inducing the shareholders to patronize the corporation. If this be so, it must equally be a question of fact in each case where the Minister contends that what appears to be an ordinary business transaction between a corporation and a shareholder is not what it appears to be but is in reality a method, arrangement or device for conferring a benefit or advantage on the shareholder *qua* shareholder.

I must now consider whether paragraph (*c*) applies to the facts of this appeal. As indicated above, for the purposes of the question I am now considering, I am assuming, without deciding, that the resolutions waiving the payments of interest had the effect of extinguishing the respondent's liabilities to pay the interest.

In considering whether paragraph (*c*) applies to the facts of this appeal, it is important to have in mind how the matter comes before the Court. The Minister, by his Notice of Appeal, set forth the assumptions on which the assessments appealed from were based. See paragraph 6 of the Notice of Appeal, which reads as follows:

6. In assessing the taxable income of the Respondent as referred to in paragraphs 4 and 5 in respect of the taxation years of 1953 and 1954, the Appellant assumed:

(*a*) that during the 1953 and 1954 taxation years the Respondent was a shareholder of Renown Mills Limited and Copeland Flour Mills Limited, both corporations incorporated in Canada;

(*b*) that on or about the 14th day of October, 1952, the Respondent borrowed the sum of $500,000.00 from Renown Mills Limited and $560,000.00 from Copeland Flour Mills Limited for the purpose of purchasing shares in the capital stock of each corporation and in respect of each loan gave promissory notes dated the 14th day of October, 1952, payable on demand, and bearing interest at the rate of 4½% per annum due and payable on the 31st day of May and 30th day of November in each year;

(*c*) that Renown Mills Limited waived the interest due and payable on the dates referred to in subparagraph (*b*) during the 1953 taxation year in the amount of $14,166.44, and during the 1954 taxation year in the amount of $22,253.42;

(*d*) that Copeland Flour Mills Limited waived the interest due and payable on the dates referred to in subparagraph (*b*) during the 1953 taxation year in the amount of $15,810.41, and during the 1954 taxation year in the amount of $24,923.84.

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The relevance of this pleading appears from the decision of the Supreme Court of Canada in *Johnston v. Minister of National Revenue*[1] per Rand J., delivering the judgment of the majority, at p. 489:

> Every such fact found or assumed by the assessor or the Minister must then be accepted as it was dealt with by these persons unless questioned by the appellant.

(For the word "appellant" in that quotation, may be substituted "respondent" for the purpose of this appeal). The respondent could have met the Minister's pleading that, in assessing the respondent, he assumed the facts set out in paragraph 6 of the Notice of Appeal by:

(a) challenging the Minister's allegation that he did assume those facts,

(b) assuming the onus of showing that one or more of the assumptions was wrong, or

(c) contending that, even if the assumptions were justified, they do not of themselves support the assessment.

(The Minister could, of course, as an alternative to relying on the facts he found or assumed in assessing the respondent, have alleged by his Notice of Appeal further or other facts that would support or help in supporting the assessment. If he had alleged such further or other facts, the onus would presumably have been on him to establish them. In any event the Minister did not choose such alternative in this case and relied on the facts that he had assumed at the time of the assessment).

The respondent did not challenge the Minister's allegation that he had, in assessing, assumed the facts set out in paragraph 6 of the Notice of Appeal. Neither did the respondent attempt to show that the assumptions were wrong in fact. The respondent did however put evidence before the Court to show exactly what the facts were and contended that those facts did not support the assessments.

It is clear that the first pair of transactions were ordinary business transactions whereby the respondent borrowed money from the two subsidiaries and agreed to pay interest.

[1] [1948] S.C.R. 186.

No attack was made on the *bona fides* of these transactions. They created the relationship between the respondent and each of the other two companies of borrower and lender.

The question whether the act of the lender corporation in extinguishing the obligation to pay interest was the conferring of a benefit on the respondent within paragraph (*c*) of subsection (1) of section 8 must, as I have already emphasized, be considered in each case as a question of fact.

The Minister, according to his Notice of Appeal, in each case assumed, in making the assessment, that the interest was waived (paragraph 6 of the Notice of Appeal) and concluded that the lender conferred a benefit or advantage within paragraph (*c*), (section B of the Notice of Appeal). In effect, the Minister takes the position that waiver of interest payable by a borrower who happens to be a shareholder of the lender is the conferring of a benefit or advantage within paragraph (*c*) regardless of the circumstances surrounding the waiver. In my view, the mere fact of waiver, even if legally effective to cancel the debt, is not sufficient of itself to bring the transaction within paragraph (*c*). To come within that paragraph, it must be an arrangement or device whereby a corporation confers a benefit or advantage on a shareholder *qua* shareholder. The Minister does not allege that he assumed, in making the assessments, that the waiver was an arrangement or device adopted by the corporation to confer a benefit or advantage on the respondent as a shareholder. There was no onus on the respondent to disprove that fact, which is essential to its being taxable, unless the Minister assumed that fact when assessing. It may be that the Minister's appeal should be dismissed on that ground.

In any event, as far as the second round of waivers are concerned, they were expressed to be settlements negotiated by a borrower with its lender under the terms of which immediate payment of a large amount of principal was to be made in consideration of interest being cancelled. There is no allegation that this quite ordinary type of transaction between a debtor and lender is a mere subterfuge whereby

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the lender corporation is conferring a benefit or advantage on the borrower *qua* shareholder and, in the absence of any issue having been made by the Minister of that question of fact, I cannot so find.

I have more difficulty, as far as the first round of waivers is concerned, inasmuch as it does seem improbable that the lender would have cancelled the interest outright, instead of merely giving time for payment, on a claim by the borrower that it was in difficulties, were it not for the fact that the borrower owned practically all the shares in the lender corporation. However, there was no allegation that the waiver was anything other than what it purported to be, that is, a lender granting relief to a borrower in difficulties. Had the transactions been attacked in the Notice of Appeal and at the trial as being a device or arrangement for conferring a benefit on the respondent *qua* shareholder, it might well have been difficult for the respondent to have resisted the attack. However no such attack was made and the assessments cannot therefore stand.

The appeal is dismissed with costs.

Judgment accordingly.